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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 646 (Sub-No. 3)

WAYBILL DATA RELEASED IN THREE-BENCHMARK RAIL RATE PROCEEDINGS

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JOINT SUPPLEMENTAL COMMENTS OF NORFOLK SOUTHERN RAILWAY COMPANY AND CSX TRANSPORTATION, INC.

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Dated: November 24, 2010

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Norfolk Southern Railway Company ("NS") and CSX Transportation, Inc. ("CSXT") submit these Joint Supplemental Comments on the Republished Notice of Proposed Rulemaking issued in this proceeding on October 22, 2010 (the "Revised NPRM").[1] The Revised NPRM seeks comments on the Board's proposal to amend its rules governing "Three Benchmark" proceedings to permit the selection of comparable movements from four historical years of Waybill Sample data, rather than limiting eligible comparison movements to the most recent available year's Waybill Sample (the present rule). *See* Revised NPRM at 2. This proposal seeks to resurrect the "four-year data range" provision first announced in *Simplified Standards for Rail Rate Cases*, STB Ex Parte No. 646 (Sub-No. 1) (served Sept. 5, 2007) ("*Simplified Standards*"), which was vacated by the D.C. Circuit in *CSX Transportation, Inc. v. STB*, 584 F.3d 1076 (D.C. Cir. 2009).

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[1] The Revised NPRM states that the Board will consider the comments and replies previously submitted in this proceeding. NS incorporates to these comments, as if set forth in full herein, all comments it previously submitted in this proceeding, namely the Joint Opening Comments of Norfolk Southern Railway Company and CSX Transportation, Inc. (filed May 3, 2010) ("NS/CSXT Opening Comments") and the Joint Reply Comments of Norfolk Southern Railway Company and CSX Transportation, Inc. ("NS/CSXT Reply Comments") (filed June 1, 2010).

Based on the rationale for the rule as stated by the Board in the Revised NPRM, the Board's proposal to revive the four-year data range rule is misguided and unnecessary. If adopted, the proposed change would further reduce the accuracy of the already rough and imprecise Three Benchmark approach. The conclusory rationale the Board now offers for the proposed change is inconsistent with the Three Benchmark approach, unsupported by the record, and does not justify the distortion of the process and rate reasonableness determinations that would be caused by the use of stale historical data.

I. BACKGROUND

A. The Simplified Standards Proceeding.

In *Simplified Standards for Rail Rate Cases*, STB Ex Parte No. 646 (Sub-No. 1) (served July 26, 2006), the Board proposed a Three Benchmark methodology for smaller rate reasonableness cases. Under the Three Benchmark method proposed in *Simplified Standards*, a challenged rate would be compared to the rates of a comparison group drawn from "the most recent Waybill Sample." *Id.* at 32-33.

During the *Simplified Standards* rulemaking, several commenters expressed concern about the inherent "regulatory lag" created by using unadjusted data from the most recent year's Waybill Sample. *See, e.g.,* Comments of Norfolk Southern Railway Co. and CSX Transportation, Inc. at 24, STB Ex Parte No. 646 (Sub-No. 1) (filed Oct. 24, 2006). Because Waybill Sample data is one-to-two years old by the time the Board generates a Waybill Sample, using even the most recent Waybill Sample means that the reasonableness of a current rate is judged by comparison to rates from one-to-two years earlier. Commenters argued that use of such lagging, stale data was a serious flaw in the Three Benchmark proposal, and urged the STB to consider a mechanism to adjust outdated Waybill Sample rates and costs to current levels. *See id.*

The final *Simplified Standards* rule rejected commenters' concerns about the inherent "regulatory lag" caused by using unadjusted Waybill Sample data. *Simplified Standards* at 84-85. The final Rule further announced for the first time that the Board would release the last <u>four years'</u> Waybill Sample, which the parties could use to develop their evidence in a Three Benchmark case. *Id.* at 79, 80. The *Simplified Standards* decision gave no justification for rejecting the Board's proposal that parties use only the most recent available Waybill Sample in favor of permitting the use of older Waybill Sample data.

A number of parties to the *Simplified Standards* rulemaking petitioned for review of the final *Simplified Standards* rule in the United States Court of Appeals for the D.C. Circuit. Ultimately, the D.C. Circuit held that the Board's expansion of the pool of Waybill Sample data without prior notice or opportunity to comment was unlawful. *See CSX Transp. v. STB*, 568 F.3d 1076, 1079-82 (D.C. Cir. 2009). The Court concluded that the Board's adoption of a four-year rule without opportunity for comment was "important and potentially prejudicial," because of the possibility that outdated information could distort the Three Benchmark analysis and results:

> [B]ecause the Board needs one to two years to gather and release the data, expansion to four years' worth of data means that the comparison groups could be drawn from movements that are up to six years old, and older data increases the likelihood of distorted comparisons and results. We thus agree with the railroads that the change from one year to four years' worth of data was important and potentially prejudicial.

Id. at 1083 (internal citations omitted). The Court therefore vacated the portion of the final rule that made four years of data available for selection of comparison movements. *See id.*.

B. This Proceeding.

On April 2, 2010, the Board served an NPRM proposing to re-impose the very four-year rule that the D.C. Circuit vacated. *See* Ex Parte 646 (Sub-No. 3) NPRM at 2. The original NPRM did not explain the Board's rationale for the proposed change. NS, CSXT, and others pointed out in their comments that the Board's failure to provide any justification for its proposed rule which would effect a dramatic change in the Three Benchmark approach and rate reasonableness determinations under that approach – would render any such new rule invalid as a matter of administrative law. *See, e.g.*, NS/CSXT Opening Comments at 1-10.

In response to comments demonstrating the fundamental flaw in its April 2010 NPRM, the Board issued a new "republished" notice of its proposal to amend its rules to authorize the use of the most recent four years' Waybill Samples in Three Benchmark cases. *See Waybill Data Released in Three Benchmark Rail Rate Proceedings*, STB Ex Parte No. 646 (Sub-No. 3) "Notice of Proposed Rulemaking" (served Oct. 22, 2010) ("Revised NPRM"). The amended notice briefly offered two unexamined rationales for the proposed rule change. First, the Board asserted that "the use of multiple years of data for the Waybill Sample would be consistent with the Board's current practice in other contexts in Three-Benchmark cases," citing its use of a four-year averaging period for the RSAM and $R/VC_{>180}$ benchmarks. Revised NPRM at 3. Second, the Board suggested that the use of multiple years of historical movement data would make more data available "which should assist the parties in selecting a comparison group that more closely resembles the issue traffic." *Id.* As NS and CSXT explain below, those rationales are fallacious and the proposed rule change would further undermine the rigor and accuracy of an approach the Board itself describes as "crude" and "very rough and imprecise." In order to avoid such further degradation of rate reasonableness analyses and generation of arbitrary results in Three Benchmark cases, the Board should decline to adopt the proposed rule.

II. THE BOARD'S FIRST RATIONALE IGNORES THE DIFFERENCES BETWEEN R/VC_{COMP} AND THE OTHER TWO BENCHMARKS.

The primary rationale the Board offers for its proposal to authorize the use of four years of historical data for the selection of comparison movements is that averaging four years of data is its current practice "in other contexts." Revised NPRM at 3. The mere assertion that the Board intends to apply a practice it follows in some other context, without more (such as explanation of whether or how the present context is similar or otherwise warrants similar treatment), is not a meaningful justification or explanation of the purpose of the change. Rather, it is simply a statement of intention to make that change. Once again, the Board has failed to articulate a rationale sufficient to satisfy the basic requirements of the Administrative Procedure Act and its own regulations. *See* NS/CSXT Joint Opening Comments at 7 (citing cases and authority). For this reason alone, the Revised NPRM is insufficient to satisfy the requirements of the Administrative Procedure Act, or to support the proposed rule change.

To the extent a rationale might be inferred from the "other contexts" assertion in the Revised NPRM, it is that the Board proposes to release four years of data for use in selection of comparison movements *because* it uses four-year averages in other contexts. As demonstrated below, the manifest flaw in that rationale is that it fails to consider that the referenced "other contexts" are dissimilar to the present context and thus provide no basis for applying a "similar" approach. Stated differently, the RSAM and $R/VC_{>180}$ benchmarks, and the purposes and functions they serve (adjusting the presumptive rate ceiling to account for the relation of the defendant carrier's recent earnings to the statutory goal of adequate revenues), are substantially different from the context and purpose of the R/VC_{COMP} benchmark (determining an R/VC ratio for movements that are most closely similar to the issue movement).

A. The R/VC_{COMP} Benchmark Serves a Different Purpose Than the Other Two Benchmarks.

The RSAM and $R/VC_{>180}$ serve as general indicators of a rail carrier's overall economic health in the short term. The purpose of these benchmarks in a Three Benchmark case is to ensure that the Board is not constraining rates in a way that undermines the Board's efforts to achieve one of its core missions – to allow "rail carriers to earn adequate revenues" over the long term. 49 U.S.C. §§ 10101(3), 10704(a)(2); *see DuPont v. CSXT*, STB Docket No. 42100, Decision at 10-11 (purpose of RSAM and $R/VC_{>180}$ and their relationship is to "serve[] as a revenue need adjustment factor" to be "applied to comparison group movements"). The regulatory goal of ensuring revenue adequate railroads in the long term would be undermined by rate regulation based on aberrational financial results for a carrier. Thus, the Board's long-stated reason for using a four-year average for these benchmarks – "to smooth out annual variations and minimize the impact of any year that may have been aberrational for that carrier" – may make sense as a mechanism to mitigate the risk of an aberrational year to the agency's core mission.

By contrast, the selection of comparison traffic and determination of an R/VC_{COMP} benchmark for comparable movements is the heart of the Three Benchmark analysis, which is essentially an R/VC comparison approach. The purpose and function of the R/VC_{COMP} benchmark is to establish the baseline R/VC ratios generated by traffic that is most closely similar to the issue movements. *See, e.g., DuPont v. CSXT*, STB Docket No. 42100, Decision at 7 (June 28, 2010) ("The purpose of the R/VC_{COMP} benchmark is to use the R/VC ratios of comparable traffic as evidence of the reasonable R/VC levels for traffic of that sort."). The Three Benchmark test is a crude test for determining whether a challenged rate is unreasonable and its only tether to the actual market for transportation is the R/VC_{COMP} comparison group. In the Three Benchmark test, only the R/VC_{COMP} bears any relation to the specific demand, market, and operational characteristics of the challenged movement itself by using the comparison group as a proxy. As the Board has summarized, the "R/VC_{COMP} benchmark accounts for the tailoring of the process to the issue traffic." *See, e.g., U.S. Magnesium* at 15. By definition, the goal of the R/VCcomp is not to smooth out annual variations; it is to reflect as accurately as possible current market conditions in which the carrier established the challenged rate.

B. The Board Has an Obligation to Use the Most Current Data When Evaluating the Reasonableness of Rates With the Crude Three Benchmark Test.

The Board has a statutory obligation to consider the reasonableness of "the rate established by [a] carrier." 49 U.S.C. § 10701(d)(1). Congress's instruction that the Board consider the reasonableness of "the" particular rate at issue requires that any rate reasonableness methodology used by the Board consider the circumstances relevant to that particular rate. One of the most critical circumstances is the transportation market conditions at the time of the carrier established the challenged rate. For a rate comparison methodology like the Three Benchmark approach, the statute requires at a minimum that the comparison group movements reflect the same market conditions that exist when the railroad established the challenged rate. Put differently, if the Board were asked to consider the reasonableness of a rate set in 2010, an analysis of whether the rate was comparable to rates from 2008, 2007, 2006 or 2005 is not a consideration of the reasonableness of the 2010 rate under the market conditions that exist in 2010. In light of the overwhelming and unchallenged evidence that NS and CSXT provided in their opening comments in this proceeding that rates and costs for historical movements are not comparable to those parameters of a challenged, current movement, adoption of the Board's proposal would violate the Board's statutory obligations and would be arbitrary and capricious. The Board may not use older, outdated Waybill Sample data (without adjusting it to reflect pricing as of the date of a shipper's complaint) instead of the most current data available.[2]

[2] By urging the Board to abandon its current proposal and continue the comparatively better approach of selecting comparison groups from the most recent year's Waybill Sample, NS and CSXT do not waive their arguments that: (i) the Board should adjust this more recent data to reflect rate levels that exist at the time a complaint is filed; or that (ii) the Board should use other,

1. <u>The Most Recent Data Most Closely Reflects Market Conditions at the Time the Carrier Established the Challenged Rate.</u>

The R/VC_{COMP} benchmark is case-specific and designed to vary based on the nature of the challenged movement, taking into consideration such factors as commodity, length of haul, and other characteristics. It also is the only benchmark in a Three Benchmark case that has any nexus to actual market conditions that affect price. The R/VC_{COMP} serves to reflect specific demand and other relevant market and operational characteristics of the challenged movement itself, using the comparison group of contemporaneous traffic as a proxy for those characteristics. Because the R/VC_{COMP} benchmark is at the heart of the Board's small rate case analysis, it is essential that the movements in the comparison group reflect, as accurately as possible, the market conditions under which the carrier established the current challenged rate so that the Three Benchmark test better and more accurately will serve its aim of establishing maximum rate levels that foster a "reasonable level of contribution to joint and common costs for the issue movement." *See Simplified Standards* at 18; *id.* at 17 (comparison group selected should be that which is "most similar" to the challenged movement).

Data from earlier time periods – especially five or six years prior to the establishment of the challenged rate – is simply *irrelevant* to the market at the time of the challenged movement. The housing market is a simple example. U.S. housing price data from five to six years ago would include home sales made at the peak of the market and before the burst of the housing bubble. No buyer or seller would rely on data from 2005 to determine how to price a house or what to pay for a home today.

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superior alternatives to the Waybill Sample, such as relying on the rail carrier's most recent annual data for the commodity at issue.

In sum, as NS, CSXT, and other commenters have repeatedly explained, the Board's proposal to authorize the use of five-to-six-year-old data for the selection of "comparable" movements would generate additional errors and distortions that would further undermine the already limited accuracy, rigor, and validity of the Three Benchmark process and its results. The Board's proposed change would significantly exacerbate a fundamental shortcoming of the Three Benchmark approach: the use of outdated, historical rate and R/VC data, without adjustment, as a mechanical measure and determinant of rate reasonableness. *See, e.g.*, NS/CSXT Opening Comments at 10-18; NS/CSXT Reply Comments at 4-5.[3]

2. <u>Older Data Increases the Likelihood of Distorted Comparisons and Results.</u>

It cannot be seriously debated that older comparison data is much less likely than more current data to accurately and reliably reflect current market conditions, rates, and prices. Similarly, it is undeniable that, regardless of the good or service in question, the older the economic and financial data, the less reliable it is as an indicator of current economic and market conditions. NS, CSXT, and others demonstrated in prior comments that rail rates and costs are

[3] NS, CSXT, and others have vigorously argued, on numerous occasions, that using even the single most recent Waybill Sample results in a substantial "regulatory lag" of as much as two years, which will lead to distorted R/VC comparisons and inaccurate results. Because using the most recent year's Waybill Sample data could result in comparisons of current rates with rates generated in significantly different markets and economic conditions, carriers have repeatedly argued that the Board should update and adjust the comparison group to the time of the challenged rate. *See, e.g.*, NS/CSXT Open. Comments at 16-18; *DuPont v. CSXT,* STB Dkt. No. 42100, CSXT Opening Evidence at 26-30 (Feb. 4, 2008); *id.*, CSXT Reply Evid. at 41-46; *id.* CSXT Rebuttal Evid. at 39-46 (April 4, 2008. However, the Board uniformly has refused to update Waybill Sample data to current terms. *See, e.g., DuPont v. CSXT,* STB Dkt. No. 42100, Decision at 7-10, 13-17. NS and CSXT maintain that the Board should eliminate this distortion, either by using current data, or by adjusting Waybill Sample data to current levels in Three Benchmark proceedings. Either adjustment would facilitate more meaningful and accurate comparisons. In all events, allowing the selection of comparison data from four historical years' Waybill Samples – which means comparison data may be up to six years old – would make this problem worse.

dynamic and change significantly over time. *See, e.g.*, NS/CSXT Joint Comments at 10-16 (May 3, 2010). As the D.C. Circuit summarized, "because the Board needs one to two years to gather and release the data, expansion to four years' worth of data means that the comparison groups could be drawn from movements that are up to six years old, and <u>older data 'increases the likelihood of distorted comparisons and results</u>.'" *CSXT v. STB*, 568 F.3d 1076, 1083 (D.C. Cir. 2009) (emphasis added) (quoting petitioners with approval).

The Board's own studies demonstrate that outdated historical data do not reliably reflect current markets. A Board-commissioned study of rail competition issued earlier this year; GAO studies; and the Board's own internal studies and analyses all confirm that rail rates and costs fluctuate substantially over time. Among other things, these studies demonstrate

- Over the course of the last 25 years, rail rates have both risen and fallen from year-to-year and over the course of different multi-year periods. Rail rates fell in the most recent full year, 2009. *See* NS/CSXT Opening Comments at 11-12.
- Rail rates for different commodities and services do not change uniformly, or at the same pace. *Id.* at 12.
- Rail transportation rates can and do change substantially over periods of three-to-six years. *See id.* at 13-14. The Board's proposal would allow the use of six-year-old movements as "comparison" movements in Three Benchmark cases.
- Rail transportation prices and costs do not move in parallel or change by the same proportion. *See id.* at 12-13.

Other economic data, including numerous price and cost indices published by the federal government, abundantly illustrate basic economic facts: prices change over time, at different rates and in different amounts and directions. This means that unadjusted price data over the course of several years – even prices for identical commodities – is a very unreliable measure of current prices. The best indicator of current prices and market conditions is current price data, or at least the most up-to-date price data available. In the present context, the well-documented variability of rail transportation costs and prices over the course of several years further buttresses the soundness of using only the most recently available rate and cost data for purposes of estimating reasonable current R/VC ratios for similar traffic.

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The validity of a rate comparison methodology such as the Three Benchmark approach depends on the use of relevant, meaningful, and accurate comparators. Given the significant potential variability in rates and prices over the course of time, meaningful and accurate comparison movements should be drawn from the most recent available data in order to give meaning to 49 U.S.C. 10701(d)(1). *See* NS/CSXT Opening Comments at 14-16. The proposed change would substantially undermine the already limited validity and accuracy of the Three Benchmark approach, without any substantial justification or significant countervailing benefit. Given the gossamer-thin rationale proffered by the Revised NPRM, the Board should retain the existing rule and require comparison movements to be selected from the most recent year's Waybill Sample.

C. Unlike the Other Two Benchmarks, the R/VC_{COMP} Is Not Derived Based on Averaging.

The R/VC ratios of comparison group movements are not averaged over time or temporally weighted in any way to derive the R/VC_{COMP} benchmark. Rather, the Board permits parties to select comparison movements from the entire unmasked Waybill Sample(s) released for the case, in whatever manner the parties see fit to advance their interests in the case. Regardless of whether the Board releases one, two, three, or four years of Waybill Samples, it does not – and has not proposed to – conduct any temporal averaging of price levels over the period covered by the Waybill Sample(s). In fact, under the Board's rules and practices, the year in which proffered comparison traffic moved plays no role whatsoever in the selection of a comparison group or in the calculation of the R/VC_{COMP}. Thus, the Board's proffered reason for using a four-year "averaging" period for the RSAM and $R/VC_{>180}$ benchmarks – to "smooth out annual variations and minimize the impact of any year that may have been aberrational for that carrier" – is entirely inapplicable and irrelevant to the selection of comparison traffic or to the R/VC_{COMP} benchmark. *See Rate Guidelines – Non-Coal Proceedings*, 1 S.T.B. 1004, 1032-33 (1996).[4]

The Board's use of a four-year average for two other benchmarks is simply not relevant to the R/VC_{COMP} benchmark or the pool of traffic from which comparison movements may be chosen. Temporal averaging in those "other contexts" is therefore not a logical or meaningful justification for the Board's proposed fourfold expansion of the use of stale, outdated data to evaluate the reasonableness of current rates. Because the Revised NPRM provides no further explanation or discussion, this vague rationale is woefully inadequate to justify any such change.

D. The Board's Rules Preclude Adjustments Necessary to Update Old Comparison Rates and Costs, Thereby Locking in the Distorting Effects of Old Data.

The Board has recognized both that the use of lagging Waybill Sample data introduces "regulatory lag" to the Three Benchmark analysis, and that some data are "too old to be reliable" for rate comparisons. *See Simplified Standards* at 85; Revised NPRM at 3. As these statements acknowledge, the greater the time period covered by comparison movements, the greater the likelihood that market and business changes will render older movements dissimilar

[4] The Association of American Railroads highlighted this logical flaw in the initial round of comments. *See* AAR Reply at 5 ("The NPR does not propose a "multi-year average" of any sort regarding the selection of comparables traffic.") And even if the Board had noticed a proposal to calculate the R/VC_{COMP} benchmark using such temporal averages for several years, such a proposal would be flawed and inconsistent with the Three Benchmark approach, because R/VC_{COMP} serves a different purpose than RSAM and $R/VC_{>180}$. *See* II.B, *supra*.

to current traffic and thus unreliable indicators of reasonable rate levels in the current market. The present NPRM, however, contains no discussion of the effects of use of older and more outdated comparison data on rate reasonableness determinations. This is surprising given that this very concern was at issue in the prior appeal; was a specific concern of the D.C. Circuit; and was raised by commenters in response to the original NPRM in this proceeding.

1. Rail Prices and Costs Change at Different Rates and R/VC Ratios are Not Static Over Time.

In *Simplified Standards*, the Board summarily dismissed the distortions that could result from determining the reasonableness of current rates based on stale outdated data – and rejected proposals for adjusting historical data to current levels – by asserting that R/VC ratios should be "unaffected" by price and cost changes, and that parties may argue that market changes not reflected in the comparison group should change the presumptive maximum reasonable rate. *Simplified Standards* at 85. The Board's counterintuitive assertion that R/VC ratios are unaffected by price changes over time depends on the fallacious assumption that rail rates and variable costs of rail transportation move together at the same time and in equal proportion, and so directly offset one another. *See id.* There is no evidence in the record to support that sweeping and highly implausible assumption. Indeed, it is artificial and contrary to actual experience to assume that rail rate and cost changes are so synchronized and move in such equal proportion that R/VC ratios for that traffic remain essentially static over time.

Further, there is substantial record evidence refuting the Board's unsupported supposition that rail rates rise and fall in direct proportion. *See* NS/CSXT Opening Comments at 12-13 (citing 2010 Christiansen Associates Final Report, a study of freight railroad competition commissioned by the Board). As the Christiansen Report, which was commissioned by this Board, dramatically illustrates, over the last two decades freight rail rates and costs have followed widely divergent paths. *See* Laurits R. Christiansen Associates, Inc., An Update o the Study of Competition in the U.S. Freight Railroad Industry at I, 2-5 (January 2010). In recognition of the fact that rail transportation prices and costs change at different rates, cases evaluated under the Stand Alone Cost ("SAC") test assume that revenues and costs do not change at the same rate. In SAC cases, the Board projects Stand Alone Railroad revenues and costs separately, using different indices and escalation factors, reflecting the reality that rail costs increase and decrease at different rates than rail revenues. *See, e.g.*, *Western Fuels Ass'n, Inc. & Basin Elec. Power Cooperative v. BNSF Ry. Co.*, STB Docket No. 42088, at 19, 30 (Sept. 7, 2007) (using EIA tonnage and rate forecasts to project SARR revenues and hybrid RCAF-U and RCAF-A approach to project SARR operating expenses).

Moreover, the Board expressly acknowledges that at some point Waybill Sample data are "too old to be reliable." Revised NPRM at 3.[5] Given this acknowledged inverse relation between the age of Waybill Sample data and its reliability for R/VC comparisons – and the Board's refusal to allow feasible adjustments to update old data – the interests of accurate and reliable comparisons dictate the use of only the most recent available data. Absent a compelling contrary justification for a different approach – which is wholly lacking in the

[5] The Board offers no justification for its arbitrary position that four-year-old Waybill Samples (which because of regulatory lag often represent six-year-old data) are appropriate for R/VC comparisons, but data from any prior year is "too old to be reliable." In fact, the substantial evidence submitted by NS and CSXT in their earlier comments in this proceeding demonstrates that rates even three or four years old are too old to be reliable reflections of the current marketplace. NS/CSXT Opening Comments at 14-15. Nor is there any evidence in the record to support such a belief, which makes this choice arbitrary. If the Board's assumption that rail prices and variable costs consistently change at the same rate and proportion were accurate, then there would be no reason to limit eligible comparison movements to the last four years' Waybill Samples. Because R/VC ratios would be "unaffected" by the passage of time, movements selected from the immediately preceding year or ten years earlier would be equally valid as comparison movements and entitled to equal weight in the determination of the current maximum reasonable rate level.

Revised NPRM – the Board should release only the most recent year's Waybill Sample for use in Three Benchmark cases.

2. The Option to Select Comparison Movements from a Single Year Would Not Meaningfully Address the Problems Created by the Availability of Four Years of Historical Movement Data.

In the Revised Notice, the Board indicated that parties may "draw their comparison groups in any combination they choose from the released Waybill Sample data." Revised Notice at 3. That option is insufficient to support the present proposal to release four years of old data for use in selecting comparison movements. Given the other requirements and limitations of the Three Benchmark process, this purported option would be meaningless and illusory. *See* CSXT/NS Opening Comments at 16-18; CSXT/NS Reply Comments at 15-16; *DuPont v. CSXT*, STB Docket No. 42100, at 15-16 (June 28, 2010).

First, neither *Simplified Standards* nor any other Three Benchmark case decision has indicated that the Board will even *consider* the timing of a movement, or its temporal proximity to the issue traffic, as a factor in evaluating competing comparison groups. *Simplified Standards* enumerated factors the Board would consider in determining comparability as "length of movement, commodity type, traffic densities of the likely routes involved, and demand elasticity." *Simplified Standards* at 17. Although the Board did not state that its factors list was exhaustive, it has consistently relied on the same list of comparison factors in each of the cases decided in the intervening three years. *See, e.g., U.S. Magnesium, LLC v. Union Pacific Railroad Company,* STB Docket No. 42114, at 5-6 (served January 28, 2010); *DuPont v. CSXT*, STB Docket No. 42101, at 7 (served June 30, 2008).[6] Thus, the Board has never considered the

[6] In the three *DuPont* cases, the defendant carrier expressly argued that comparison movements should be drawn from only the most recent Waybill Sample, in part because prior years' data was not sufficiently comparable. *See, e.g.,* STB Docket No. 42101, CSXT Opening Evidence at 12-18 (filed Feb. 4, 2008); *id.*, CSXT Opposition to Motion to Compel at 2, 5-12, 17-18 (filed

timing of proffered movements in evaluating competing comparison groups, and has given no indication that it would consider that parameter a relevant "factor" for purposes of selecting a comparison group.[7]

Second, the Board's evidentiary rules in Three Benchmark cases effectively preclude the parties from presenting probative evidence of specific market changes (including rate and cost changes) in support of their comparison group. The Board allows only two types of evidence to be presented in the all-important comparison group selection phase of Three Benchmark process – data contained in the Waybill Sample and publicly available information. *See Simplified Standards* at 84. As a practical matter, only non-public, commercially sensitive data not contained in the Waybill Sample would be sufficiently specific, detailed, and robust to demonstrate market rate and cost changes for specific types of traffic. Publicly available data concerning rail rates, revenues, and costs are too general and are limited to broad categories of traffic (*e.g.* "chemicals") that do not show more granular changes in specific rail transportation prices and costs.[8] Parties to rate cases have in their possession confidential data that, under

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Dec. 28, 2007). The Board flatly refused to even consider this argument. *See, e.g., DuPont*, STB No. 42101, at 1 (rejecting argument as a "collateral[] attack").

[7] Prior comments included other reasons that selection of comparison movements from a single year's Waybill Sample would be tactically unwise and unreasonable in a system in which four years' of Waybill Sample movements were available. *See, e.g.*, NS/CSXT Opening Comments at 18-20.

[8] In one of the *DuPont* cases, CSXT offered the most specific publicly available data it could find showing that its rail rates for chemicals traffic had changed dramatically during the four historical years covered by the most recent Waybill Samples and the intervening period leading up to the time of the issue movements. *See, e.g., DuPont v. CSXT*, STB Docket No. 42100 CSXT Opening Evidence at 26-30 (filed Feb. 4, 2008); *id.*, CSXT Reply Evid. at 41-46, V.S. Piacente (filed Mar. 5, 2008); *id.* CSXT Rebuttal Evid. at 39-46 (filed Apr. 4, 2008). The Board declined to even consider that evidence in its selection of the comparison group. *See DuPont*, STB Docket No. 42100, at 7-10, 13-15; *see also id.* at 15-17 (refusing, in the other relevant evidence phase, to adjust R/VC levels to reflect detailed non-public information produced in discovery showing dramatic market and pricing changes during the five years in question).

appropriate confidentially restrictions and protections, could be used to demonstrate specific market changes that render older data non-comparable. The rule prohibiting the use of such non-public information, however, effectively deprives parties of a meaningful opportunity to prove that market changes make more recent movements more comparable to current movements.

Third, the Board's requirement that parties quantify the precise effect of other relevant evidence on each of the benchmarks and the resulting R/VC ceiling effectively precludes adjustments to the presumptive maximum reasonable rate established in the first, comparison group phase of the case. In *DuPont*, for example, the defendant carrier presented detailed, specific evidence showing current rail rates for the commodity in question. While the Board did not question that rates and costs for the type of traffic at issue had changed substantially over the relevant period of five-plus years (2002 to 2007), it refused to make adjustments to the presumptive maximum R/VC ratio to account for those market changes. *See id.* In addition to repeating *Simplified Standards'* discredited supposition that rate and cost increases generally offset one another, leaving R/VC ratios constant, the Board rejected the adjustments CSXT proposed because CSXT did not make corresponding modifications to the RSAM and $R/VC_{>180}$ benchmarks. *Id.* at 16. The unavailability of necessary data,[9] in combination with the immense effort required to update the two benchmarks to current terms render the showing required by the Board extremely impractical (and expensive) and likely impossible. Thus, it is no answer for the Board to assert that parties may offer "other relevant factors" to overcome distortions in the presumptive maximum reasonable rate caused by the use of outdated Waybill Sample data.

[9] For example, "regulatory lag" means essential Waybill Sample data and railroad cost of capital for the current year – and often the preceding year – do not exist.

Fourth, under the Board's rationale, any party who proffered a comparison group consisting of movements from only the most recent Waybill Sample would place itself at substantial litigation risk, because the Board has endorsed the use of four years of data to "smooth out annual variations." Revised NPRM at 3.[10] If, in an attempt to account for market changes not reflected in stale older data, a party were to submit comparison movements drawn from only the most recent year (and argue they were more comparable because they avoid most of the time lag) and the adverse party submitted comparison movements drawn from multiple years (arguing that this approach would "smooth out annual" price "variations"), the party relying upon the most recent year's movements would be at a substantial disadvantage. Indeed, if the Board were to adhere to the proffered rationale that use of data from multiple historical years is desirable to would avoid use of "data that may be aberrational," it would be tactically foolish for a party to select comparison movements from only the most recent year.

Fifth, the Board's proposal creates a risk of exacerbating the distortion caused by regulatory lag because a comparison group could consist solely of older data, without "smoothing" with more recent data. For example, the proposed change would allow selection of a comparison group comprised entirely of six-year-old movements, regardless of how relevant market conditions (including prices and costs of the issue traffic) had changed over that period. The Board would then rely upon the stale and outdated costs and revenues of the comparison group movements, without adjustment, to compute the governing R/VC_{COMP} ratio, the principal determinant of the maximum reasonable rate under the Three Benchmark approach. Because the

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[10] As demonstrated, such a rationale is wholly at odds with the purpose of the R/VC_{COMP} benchmark, which is to establish baseline R/VC ratios for traffic that is most closely similar to the issue movements at the time the challenged rate is established. If there are annual price variations, those variations reflect current market conditions that should be captured in the R/VC_{COMP}, *not* be "smoothed out" or homogenized to make them more like some other years.

"other relevant evidence" phase offers no realistic opportunity to overcome the presumptive reasonable rate established in the benchmark phase of the case, the effect of use of outdated movement data would be to lock in outdated R/VC ratios for current traffic, regardless of how market conditions may have changed.

In sum, the Board could not accurately contend that parties to Three Benchmark cases are afforded a fair and meaningful opportunity to demonstrate that a comparison group containing more recent movements should be selected over one comprised of older data.[11] The comparability factors the Board considers do not include the dates of the movements or the resulting age of movement data. And even if the Board were to consider that factor, its rules prevent the parties from presenting probative evidence. Moreover, the potential remedy of permitting a party to submit a comparison group with data drawn from a single year of data is at most illusory for the railroad and a potential source of exaggeration of the lag problem.

III. THERE IS NO EVIDENCE THAT USING THE MOST RECENT YEAR'S WAYBILL SAMPLE WOULD PERMIT THE SELECTION OF COMPARABLE GROUPS THAT MORE CLOSELY RESEMBLE THE TRAFFIC AT ISSUE.

The secondary rationale suggested by the NPRM is that the use of additional – older and more outdated – data for selection of comparison movements may somehow result in comparison groups that "more closely resemble[] the traffic at issue." Revised NPRM at 3. The proposed change would likely have the opposite effect: the use of data generated in several different historical years and under different economic and market conditions from the issue traffic will result in comparison groups that <u>less</u> closely resemble the current issue traffic. As demonstrated above, market and economic changes over time mean that the older the data in the

[11] The Board has not presented any such rationale for the proposed rule change in this proceeding. *See* Revised NPRM. Therefore, unless the Board issued a new notice articulating such a rationale, governing administrative law would preclude it from relying on that rationale to support the proposed rule.

selection pool, the more likely that the costs and revenues of otherwise similar movements will materially diverge from those of issue traffic. Such changes over time, which are inevitable in dynamic transportation markets, make older movements less similar to and less accurate comparators for current movements. Thus, the proposed rule change would foster comparison groups that less closely resemble the issue traffic, thereby significantly undermining both the R/VC_{COMP} benchmark and the core purpose and goal of the Three Benchmark approach.

The Revised NPRM briefly suggests, without elaboration, that limiting the selection of comparison movements to the most current Waybill Sample might result in comparison groups that are "too small." The Board does not explain what size comparison group it would consider "too small" or what standards or criteria it would use to make such determinations, or what it fears might be the consequences of a comparison group that is too small. The indefiniteness of this vague concern precludes specific comment or analysis. As a general matter, however, the evidence and the Board's experience to date does not support a concern that selection of comparison movements from the most recent year's data will result in small comparison groups.[12] Unsupported speculation about the possibility that some future comparison group may be, in some undefined sense, "too small" is a wholly insufficient basis to justify the distortion of the Three Benchmark process and results inherent in the use of multiple years of old data.

Available evidence further suggests that comparison group size is not likely to be a significant issue in most cases. Three of the four Three Benchmark decisions issued to date contain no mention – let alone analysis – of the size of the comparison group or the number of comparable movements available in the Waybill Sample. The fourth case included a brief

[12] The single arguable exception is movements of chlorine. As discussed below, however, the Board is addressing this concern in a separate pending rulemaking regarding TIH commodities.

discussion of the limited number of available comparable movements for chlorine, a unique commodity whose characteristics and requirements distinguish it from all other traffic. *See U.S. Magnesium v. Union Pacific*, STB Docket No. 42114 (Jan. 27, 2010). As explained below, that case and commodity provide no basis to use four historical years of Waybill Sample data for all Three Benchmark cases.

In *U.S. Magnesium,* the Board identified "two pivotal issues" as important to the determination of the appropriate comparison group: the exclusion of movements of the issue commodity in favor of a different commodity, and the use of re-billed movements rather than single-line movements. *See id.* at 7-8. After considering all of the comparison factors identified by the parties (none of which included a claim that either of the proffered groups was "too small"),[13] the Board conducted its own further analysis to resolve the two pivotal issues and select the final comparison group. *Id.* at 11.[14]

The Board's only mention of a concern about the available number of comparable movements demonstrates that the change proposed in this proceeding would not remedy the concern, and highlights the Board's separate development of an alternative solution that does not require the use of distorting older data. In a footnote, the Board indicated that flaws in the parties' proffered comparison groups may have been attributable to "limitations in the number of comparable movements in the [four years'] Waybill Sample." *Id.* at 9, n.12. Importantly, the parties in *U.S. Magnesium* used four years' Waybill Samples, exactly what the Board has

[13] The parties disagreed on five factors, none of which was the size of the comparison group. *See id.* at 7.

[14] In response to the dissenting opinion, the majority decision reiterated the basis for its selection of the complainant's comparison group (its analysis of the two pivotal issues) and in the process briefly mentioned that "residual differences" such as mileage bands and the "number of observations" also favored the complainant's group. *Id.* at 12. This is the Decision's sole mention of sample size playing any role whatsoever in selection of the final comparison group.

proposed in this proceeding. In other words, in the only case in which the Board has identified the available number of comparable movements as a concern, the availability of four years of historical Waybill data did not alleviate that concern.

Moreover, as the Board went on to explain, it is developing an alternative solution to address the potential problem of undersized comparison groups without using older data. *See id.* at 9, n.12 (citing the pending TIH Waybill reporting rulemaking, Ex Parte 385 (Sub-No. 7)). As discussed, the only case in which the number of available comparison movements apparently has arisen was a case involving the movement of chlorine, whose characteristics and risks render it dissimilar to nearly all other commodities transported by rail. To address this unique concern, the Board is in the process of amending its rules to significantly expand the number of TIH movements included in each year's Waybill Sample, by requiring carriers to include one hundred percent of their TIH movements in their annual Waybill Sample, starting in January 2011. *See Waybill Reporting for Toxic Inhalation Hazards*, STB Ex Parte No. 385 (Sub-No.7) (served Jan. 28, 2010).

As the Board explained, the expanded pool of TIH movements in the annual Waybill Sample "would be beneficial in Three Benchmark rail rate cases involving TIH traffic," the only category of traffic that has been identified as potentially having too few comparable movements to generate a robust- sized comparison group. *Id.* at 2. The proposed expansion of each year's Waybill Sample to include all TIH movements would make available "more data to draw upon when forming [] comparison groups; therefore, the parties could construct comparison groups that would be more comparable to the issue traffic." *Id.* Importantly, the proposed change in the data reported in each annual Waybill Sample would expand the number of comparison movements without resorting to the use of older data from prior years.

In the event that a Three Benchmark case were to present a genuine, material shortage of "useable" comparable movements, the Board's existing rules already provide a remedy. *Simplified Standards* provided that in such truly extraordinary circumstances, the Board may allow the parties to go beyond the Waybill Sample to select comparable movements from the defendant carrier's full traffic data. *See Simplified Standards* at 83. But other potential solutions, such as a somewhat expanded STB Waybill Sample for other commodities or use of the defendant carrier's current waybill data for movements of the same commodity rather than the sample, are far superior solutions to the perceived problem of potentially too few comparable movements in the annual Waybill Sample than the change proposed in this proceeding.

In sum, the proposed new TIH Waybill Sample rules amply address the only instance in which there is any evidence whatsoever that the number of movements available in the most recent Waybill Sample might be a concern. And existing rules already provide an adequate remedy should the Board determine in some future case that the most recent Waybill Sample contains too few comparable movements.[15] Unsupported speculation about potential future shortages of comparable movements in the most recent Waybill Sample is no basis for the distortion of the Three Benchmark process and results that would be created by proposed use of four years of outdated data.

[15] As previously discussed, the Revised NPRM does not explain how the Board would determine that a comparison group is "too small" or whether the small size of a comparison group is due to the limited availability of comparable movements or parties' decisions not to include certain comparable movements. Those and other underlying issues would have to be addressed before the Board could make a reasonable determination that the comparison groups proffered by both parties would be "too small." Obviously, relative comparison group size may be an appropriate criterion for the Board to use in deciding between competing groups. All other factors being equal, if one party offers a comparison group that is, by some appropriate standard, "too small" and the other party's group is not too small, the Board could select the latter group.

CONCLUSION

The vague and limited rationale set forth in the Revised NPRM is wholly inadequate to support or justify the proposed rule change. The proposal is unnecessary, unwise and unjustified, and should be rejected. The Board should not adopt the NPRM's proposed modification to the Three Benchmark approach.

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Dated: November 24, 2010

CERTIFICATE OF SERVICE

I hereby certify that on this 24th day of November, 2010, I caused copies of the Joint Supplemental Comments of Norfolk Southern Railway Company and CSX Transportation, Inc. to be served by first-class mail or more expeditious means on all Parties of Record in STB Ex Parte 646 (Sub-No. 3).

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